

# **Industrial development in buyer-driven networks:** *the garment industry in Vietnam and Sri Lanka*

*Published in Journal of Economic Geography 2004 (4): 545-564*

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# Industrial development in buyer-driven networks: the garment industry in Vietnam and Sri Lanka

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## Abstract

The garment industry in Vietnam has been included in global buyer-driven networks since the 1990s. Industrial upgrading takes place, but the changes are generally small and incremental. Profit margins tend to decline and backward linkages in the home country are few. The garment industry in Sri Lanka was included in buyer-driven networks already in the 1980s and shares this experience. The objective is to explain what processes and mechanisms that lead to this outcome and discuss in what respects it is a result of contingencies and in what respects impediments to industrial development are inherent to buyer-driven networks.

**Keywords:** Buyer-driven networks, textile and garment industry, Vietnam, Sri Lanka

**JEL classification:** F02, F14, L24, L50, L67, O14

**Date submitted:** 19 August 2003 **Date accepted:** 6 March 2004

## 1. Introduction

The garment industry in Vietnam has been included in global buyer-driven networks since the 1990s. Vietnam is an economy in transition from state socialism to market orientation since the promulgation of *doi moi* (economic renewal) in 1986. In contrast to Vietnam, Sri Lanka is a western-oriented country that has pursued an export-oriented industrial strategy since the late 1970s. The garment industry in Sri Lanka was already included in buyer-driven networks in the 1980s. Despite important differences between the two countries, the outcome of inclusion in buyer-driven networks in terms of industrial development is in many respects similar. Both countries have experienced significant growth of the garment industry, although it is presently declining in Sri Lanka. In both countries industrial upgrading takes place, but the changes are generally small and incremental. Profit margins tend to decline and backward linkages to the textile industry and other suppliers of inputs and machinery in the home country are few (Knutsen, 2003a,b). Theoretical arguments as well as empirical data on the scope of industrial development in buyer-driven networks are contrasting. Buyer-driven networks have been favourable to the process of industrialization in Taiwan, South Korea and Hong Kong, i.e., the first generation newly industrialized economies (NIEs), whereas countries in the Caribbean Basin have experienced industrial truncation (Gereffi, 1996; Mortimore, 1999). In the 1990s manufacturers in Mauritius

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who upgraded to fashion products with their own private labels and brand-names soon had to return to the manufacture of basic garments (Gibbon, 2000). Meanwhile large domestic manufacturers in Turkey managed to develop original brand-name products that are sold internationally and some have entered into retailing in Turkey (Tokatli, 2003).

The objective of this article is to explain processes and mechanisms that lead to the difficulties that the garment industry in Vietnam and Sri Lanka experiences and to contribute more knowledge on the role of buyer-driven networks for industrial development. We will discuss in what respects the outcome in the two countries is a result of time and place-specific contingencies and in what respects impediments to industrial development are inherent to buyer-driven networks.

Industrial development refers both to industrial growth and industrial upgrading. In the case of Vietnam and Sri Lanka it is development within an industry that is in focus and not contribution to industrialization at large. Industrial upgrading includes more cost-efficient production, shorter lead-time, and production of higher quality products<sup>1</sup> In other words, it entails technological and organizational upgrading. Moreover, linkages between the garment industry and its supplier industries are important to sustain the development of the industry in the longer run. In order to compete in the fashion market, increasingly shorter lead-times are required and this calls for a competitive local supply base (Gereffi, 1996; Kelegama and Foley, 1999).

The article starts with a presentation of the analytical framework. Then follows a description of the international context and the respective local contexts that the garment industry in the two countries has been subject to over time. This leads to a comparison of the performance of the garment industry in the two countries. In the concluding part, the findings are discussed in light of time-place context at the national and international scale and theoretical arguments regarding the nature of buyer-driven networks.

## 2. Analytical framework

### 2.1. The networks approach

The analytical framework is inspired by the commodity chains approach (Gereffi et al., 1994). However, a networks approach is preferred in line with recent sympathetic criticism of the commodity chains approach (Hughes, 2000; Dicken et al., 2001; Henderson et al., 2002; Smith et al., 2002). The main advantage of the networks approach is the strong emphasis on time-place context. A commodity chain refers to the linkages that constitute input acquisition, manufacturing, distribution, marketing, and consumption of a commodity. The concept has three dimensions. The input-output structure is the sequence of value-adding activities that make up the final product. Territoriality refers to the spatial dispersion of the economic activities, and finally governance structure and power relations determine allocation and flow of resources in the chain (Gereffi et al., 1994). This resembles the networks approach. It builds on the notion that social relations between actors turn a value chain into a network, and that social relations in the form of power relations are essential to understand how networks operate. However, advocates of the networks approach argue that in practice analyses of commodity chains mainly focus on

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1 Lead-time is the time it takes from an order is placed to the product reaches the market.

firm-to-firm relationships. In addition to firms, it is important to include business associations, government agencies, trade unions, NGOs, consumer groups, and individuals (Taylor, 1994; Leslie and Reimer, 1999; Hughes, 2000; Henderson et al., 2002). Another point raised by advocates of the networks approach is that complex webs of interdependence characterize the connections between the actors. This contrasts the unidirectional formation of commodity chains, which start at the node of production and end at the node of the final consumer (Leslie and Reimer, 1999; Hughes, 2000).

Regarding power relations, the commodity chains approach distinguishes between industries that are part of either buyer-driven chains or producer-driven chains. Buyer-driven chains or networks are found in labour-intensive consumer goods and the lead firms that control and co-ordinate production are retailers, designers, and trading companies, mostly from the developed countries in the North. In contrast, producer-driven chains or networks are controlled by large vertically integrated enterprises with technology-intensive production. The networks approach, however, opens for the fact that both types of networks may co-exist in an industry and that it may vary from country to country what type of network an industry is part of (Smith et al., 2002). The point of departure of the networks approach is that 'networks are always localised, working in real places and at specific times' (Hughes, 2001, p.178). Hence, the outcome of being included in a specific type of network 'cannot be read-off from the logic of the network's organisation and distribution of corporate power within it' (Henderson et al., 2002, p.446). More precisely, this is because government and other agencies such as trade unions and industry associations influence the strategies of firms and because their interests and influence vary by location (Henderson et al., 2002). Likewise, Dicken et al. (2001) hold that territoriality in terms of national institutional differences is of significant importance to the outcome of inclusion in networks. This can be illustrated by the above cases of Mauritius and Turkey. Capital was less of a constraint to technological upgrading in Turkey than Mauritius. The unpredictable economic environment in Turkey has resulted in speculative money markets of which companies have managed to take advantage. In Turkey there are also close relationships between industrialists and company-owned or company-managed banks (Tokatli, 2003).

Generation of value and industrial development are part of the same processes. The commodity chains approach addresses where value is generated and appropriated in order to explain inequalities between places. This is further theorized in the networks approach. Value refers both to the Marxist concept of surplus value and the concept of economic rent, i.e., returns to scarce assets (Henderson et al., 2002). The point of departure of Smith et al. (2002) is that value is created through the labour process. Networks can thus be considered 'mechanisms to enable increases in productivity, reductions in the value of labour power and reductions of turnover time of capital to enhance the extraction of surplus value' (Smith et al., 2002, p.51). Kaplinsky (2000) distinguishes between different types of rents that can be attained in networks (below). Henderson et al. (2002) add to this the dimensions of creation, enhancement, and capture of rents: first, may the enterprises in question *create* rents? Second, under what circumstances can the rents be *enhanced* either within or without a given network? Third, to what extent are the rents *captured* or retained locally? Similarly, the analysis of industrial upgrading will focus on whether industrial upgrading takes place at all and if it does, in what ways. Then it will be examined in what respects upgrading is assisted by buyers and finally whether manufacturers who upgrade production benefit from improving profit margins.

## 2.2. Buyer-driven networks in the garment industry

Acknowledging the above fact that an industry may be part of both buyer-driven networks and producer-driven networks, it is buyer-driven networks that are *typical* of the textile and garment industry. The phenomenon has developed in the textile and garment industry since the 1970s when firms in Europe and the USA started to source garments from local firms in the first generation NIEs, as an alternative to establishing their own subsidiaries. Buyer-driven networks are a form of functional integration of internationally dispersed economic activities that are characteristic of economic globalization. At the industry level, increasingly more manufacturers in high-cost countries suffer severe competition from manufacturers in low-cost countries that are also capable of manufacturing products of good quality (Kaplinsky, 2000). In order for firms in high-cost countries to survive and remain competitive, they have to find alternative ways to earn a surplus. In the garment industry this is design and marketing in combination with control and co-ordination of suppliers.

*Theoretical arguments* that inclusion in buyer-driven networks is conducive to industrial development focus on the fact that lead firms tend to avoid production and rather do design and marketing. This implies that they do not usually manufacture goods that compete with the goods of their suppliers. Hence, in addition to securing market outlets for the suppliers, the lead firm may also be more willing to transfer advanced technology, especially in the field of organizational learning (Gereffi, 1999). Kaplinsky (2000) argues that because barriers to entry in production have fallen and competition is increasing, the lead firms have to base their profits on systemic efficiency and *relational rents*. This is done by improving the efficiency of the individual nodes in the network and the co-ordination between them. This necessitates technological and organizational upgrading of the suppliers who can then earn *technology rents* and *organizational rents*. Technology rents arise from knowledge and equipment for production of unique products and from knowledge and equipment to attain more cost-efficient production than the competitors. More specifically, *organizational rents* accrue from the organization of the production line and logistics within the enterprise, for example to reduce lead-times. Relational rents are of the interorganizational type and accrue from management of and collective efficiency in the network.

Industrial upgrading does not guarantee that the manufacturers attain a surplus, which is required for reinvestment in order to sustain development of the industry in the longer run. Theoretical arguments that inclusion in buyer-driven networks may impede industrial development focus on asymmetrical power relations among the actors in the network and capture of value. Lead firms from developed countries capture value from the periphery by co-ordinating and controlling the links that tie the network together. They can appropriate higher levels of relative surplus value when production takes place in low-cost locations as opposed to high-cost locations (Smith et al., 2002). Likewise, lead firms can obtain high profits by combining production of brand-name products in low-cost countries with premium prices for the same products in high-cost countries. *Brand-name rents* are attained by marketing and product differentiation. Moreover, in times of economic downturn and industrial restructuring, enterprises may pass down adjustment costs to their suppliers (Semlinger, 1991).

In a study of the garment industry in Europe, Smith et al. (2002) argue that lead firms in Western Europe appropriate a large share of surplus value and that it is the relatively low labour costs in low-wage areas that are the key factor in the high levels of

appropriation. An example is the garment industry in Slovakia where 'it is not unusual for only about 7–10% of the final value of the product to accrue locally, and then only a fraction of that value is seen by the workers' (Smith et al., 2002, p.52).

To manufacturers industrial upgrading is a means to create value in order to increase profits. If industrial upgrading takes place, but profit margins remain stable or decline, this implies that other actors in the network, be they buyers or final consumers, capture the value and thereby impede further upgrading. Another sign of capture of value is when manufacturers are compelled to cut their prices in order to keep their buyers.

In order to further develop theory on buyer-driven networks, one needs to attain more systematic knowledge on what explains positive and negative experiences of such inclusion. The understanding in the networks approach that time-place contexts affect the outcome of social processes is essential in this regard. According to Gereffi (1996, p.66) industrial development in buyer-driven networks is possible in peripheral areas given 'appropriate local conditions'. As in the first generation NIEs, export-oriented firms should be subject to national policies of controls and incentives that promote backward linkages to local suppliers. However, not only are international economic conditions different from the time when these countries developed their garment industry. According to Senghaas (1985), the later the economic development process starts, the more difficult it is to succeed because the power and technological competence that rest with the leading countries tend to push the less developed countries towards peripheralization. This he refers to as displacement competition and it parallels the notion of asymmetrical power relations in theory of buyer-driven networks. Based on an historical review of the European experience, Senghaas argues that the strategy implication for success for latecomers is selective protection, or strategic targeting by the state through an elaborate system of regulations and incentives as advocated by Gereffi (1996) and Lall (1996). In the context of economic globalization and liberalization in the 1980s and 1990s, one can expect that this strategy is difficult to pursue.

### 2.3. The two case studies

Both case studies are of a theoretically informed and explanatory type. Vietnam was selected for the study as a late latecomer to buyer-driven networks, while Sri Lanka is an earlier entrant to the global market. Both countries were brought into the buyer-driven networks of the textile and garment industry by triangle manufacturing. This is a system in which enterprises in the first generation NIEs act as regional co-ordinators of the networks and source products from local manufacturers on behalf of the lead firms in the North (Gereffi and Korzeniewicz, 1994; Gereffi, 1999). Vietnam and Sri Lanka are also both peripheral countries in which the garment industry is important to the overall economy. In line with the arguments of Senghaas (1985), one could expect that Vietnam would have more difficulties in attaining industrial development in buyer-driven networks than Sri Lanka due to increasingly keener competition and pressure by lead firms. One can also expect that enterprises in Vietnam lack important information regarding access to markets and knowledge on how to manoeuvre in an international capitalist economy, and that this in turn weakens their leverage in negotiations for gains in the networks. Transition economies have been dissociated from the international capitalist economy for a long time, while the latter has become increasingly sophisticated. This means that catching-up is difficult (Lines, 1998).

The primary data is qualitative and based on long semi-structured interviews with a range of different sources. This is combined with national and international statistics, newspaper clippings, and other studies and reports on the industry. The fieldwork in Vietnam took place in April–June 2002. The interviews were made in Hanoi and surroundings and Ho Chi Minh City and surroundings. Nineteen garment manufacturers representing state enterprises, state enterprises in joint ventures, private Vietnamese enterprises, and foreign enterprises were selected. A textile manufacturer and a manufacturer of textile luggage were also included as well as a state-owned buying company, four foreign buying companies, three foreign suppliers of accessories, machinery, and information technology, and representatives of four industry associations. In Sri Lanka, data collection took place in September 2000. Interviews were made in eight buying offices, four garment factories, an institute of clothing technology, a branch association of the buying offices, and a branch association of manufacturers. The primary data for Vietnam is more comprehensive than for Sri Lanka, but it was easier to get access to detailed secondary statistical material for Sri Lanka. In sum, the quality of the data is satisfactory in terms of reliability and validity. The point is to examine the outcome of processes in different contexts. Hence, the difference in time between the case study in Vietnam and Sri Lanka can be justified.

### 3. International context

The garment industry is a technologically mature industry with low barriers to entry, and a relatively flat and price-sensitive market. After 1945 more countries that had embarked on an industrial strategy of import-substitution started to export textiles and garments. The USA and countries in Europe relocated production to lower cost countries and resorted to different agreements on quantitative restrictions in order to meet the competition. The quota system of the Multifibre Arrangements (MFA) is scheduled to be abolished by 2005 and bring the textile and garment industry into the GATT framework. The phase-out of the quota system started in 1995 and is a process that intensifies competition in price and lead-times.

Changes in fashion is a means to stimulate demand and the industry already caters to 6–8 buying seasons a year. This requires high flexibility and short lead-times and can be obtained by higher efficiency in the network and closer proximity to suppliers and the market. In the 1990s there were signs that the industry becomes more regional in orientation (Gereffi, 1994, 1999; Mortimore, 1999). Proximity reduces lead-times. In addition, duty and tax concessions within free trade zones in a given region attract buyers because it makes manufacturers more competitive in price and is a source of trade policy rents<sup>2</sup> It is, however, important to keep in mind that geographical proximity per se does not out-weigh the importance of costs when sourcing decisions are made: According to Scandinavian buyers, ‘costs are the point of departure, then quality and proximity tip the decision in either direction’. Price competition from China is severe in the international market and with further abolition of the quota system, cheap exports may reverse the processes of regionalization. China has already gained market shares in the USA at the expense of Mexico as well as a number of other

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2 Buyers refer to direct buyers such as representatives of the lead firms and middlemen.

developing countries (ATMI, 2003; WTO, 2003). In Europe the market is more diversified than in the USA. While bulk items are usually imported from the Far East, the Pan-Euromed zone is the source of replenishment of products that sell well and are required fast (interviews in Vietnam, Turkey, and Scandinavia)<sup>3</sup>.

Despite the tendency of increasing regionalization in the 1990s, Asian developing countries accounted for as much as 54% of the global exports of garments in 2000 and Asia is the region with the largest exports both to the EU and the USA. China has become the biggest exporter of textiles and garments in the world, but Italy, Germany, the US, Japan, France, and Belgium belong to the ten leading exporters of textiles. Excepting Japan and Belgium, these countries also belong to the top ten exporters of garments (WTO, 2001a, 2001b). Manufacture of textiles, which is more capital-intensive than garments, has to a larger extent remained in the higher cost countries. As companies from countries in the North co-ordinate and control the bulk of garments exported from developing countries in addition to their own production, it is evident that their position in the industry is still strong.

World exports of textiles reached US\$126 billion in 2000. Since 1990 there has only been a slight increase. Exports of garments, in contrast, have experienced a gradual increase from US\$108 billion in 1990 to US\$166 billion in 2000, but it mainly reflects increases in exports from China and to some extent Turkey (United Nations, 2001).

#### 4. Local contexts

Both in the socialist economy of North Vietnam and the capitalist economy in the South, the textile and garment industry relied on imports of capital goods and raw materials, and until the 1970s the industry primarily catered to the domestic market (Hill, 1998). When North and South Vietnam became one nation in 1975, state-owned enterprises (SOEs) were established in the South too. Due to a number of economic problems, it was decided in 1986 to transform the centrally planned economy to a multisectoral economy guided by market principles (Wolff, 1999). Private Vietnamese enterprises were recognized as positive contributors to the economy and given legal status. For the SOEs, *doi moi* implied elimination of centrally planned production targets, and introduction of profit-based accounting and self-management in finance. Mergers and closures have reduced the number of SOEs, but the process of privatization of SOEs has been slow.

A number of studies conclude that preferential treatment of SOEs regarding access to land, credit, export quotas, and information about markets has restrained growth in the industry. Moreover, unclear and complex regulations, which are unevenly implemented across regions, arbitrary taxation, and bureaucratic complexities and harassment, are factors that have affected growth negatively in both private and state enterprises (Hill, 2000; MPDF, 2000, 2001; Nguyen Thang, 2001). In the same vein, the Japanese External Trade Organization (JETRO, 2002a, b) writes that the disadvantages of being located in Vietnam are complicated administrative procedures, imperfect legal framework and implementation of regulations, and shortages of supply of domestic parts and components. Advantages of production in Vietnam are few labour disputes and a low demand for wage increases in addition to a stable socio-economic environment.

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3 In addition to Western Europe, the Pan-Euromed zone includes North Africa, Eastern Europe, and Turkey.



Sri Lanka pursued import-substituting industrialization from 1956. In 1977 there was a shift to export orientation with establishment of export-processing zones (EPZs). The output value of the textile and garment industry increased significantly already in the early 1970s under import substitution, but this was mainly due to increases in the textile sector. It is the garment industry that accounts for the impressive growth in the 1980s and 1990s. From 1993 the whole garment industry has enjoyed the privileges of an EPZ-status. This includes duty-free inputs, low interest on credit, tax exemptions, tax reductions, and freedom to repatriate profits (Slater, 1997; Kelegama and Foley, 1999).

Quota hopping<sup>4</sup> and a favourable cost-level stimulated export-oriented garment industry in Sri Lanka. Labour costs were low in comparison with Taiwan, South Korea, India, the Philippines, and Malaysia and productivity was among the highest in the Asian garment industry (Business Asia reference in Vidanapathirana, 1986). Because skilled labour is no longer abundant, wages are forced upward (interviews), and labour productivity in Sri Lanka is low compared with the most competitive countries internationally (Bharattextile.com, 2003). As late as in the interviews in 2000, buyers answered that cheap labour is a reason for their involvement in Sri Lanka. However, their decisions are based on a totality of factors which also include advantages of a high level of literacy, the British background and skills in English, a favourable exchange rate, and honesty and seriousness of the suppliers. Other positive factors are the western orientation of Sri Lanka politically and the export-led strategy of industrialization. Manufacturers claim that Sri Lanka benefits from the fact that the buyers want to diversify risks.

None of the two countries have implemented a systematically targeted export-import policy such as the first generation NIEs, and in both countries there is a demand for workers and personnel with better technical and organizational training.

## 5. Growth and decline

In constant 1994 prices, the *output* of the textile and garment industry of Vietnam increased from 9126 billion Vietnamese dong (VND) in 1995 to 14320 billion VND in 1999. Out of this garments accounted for 32% in 1995 and 54% in 1999 (GSO, 2000). From 1985 to 2001 *exports* of textiles and garments increased from US\$27.6 million to US\$1962 million (Table 1). In the period 1995 to 2001, the share of garments in the exports of the textile and garment industry has remained close to 80%, i.e., slightly lower than in the case of Sri Lanka (based on figures in VITAS, 2002).

In 2000, 46% of the exports went to the EU, 38% to Japan, and 3% to the USA (WTO, 2001b; GSO, 2000).<sup>5</sup> The shares destined for the EU and the USA increased. In the wake of the bilateral trade agreement effective from December 2001, more than 10% of the exports of garments went to the USA in 2002 (Vietnam News Brief Service, 28 October, 2002). Quota regulations were imposed by the USA in May 2003. Other quota markets for Vietnam are the EU, Canada, and Turkey (Hoàng Thi Chinh, 2002). The Japanese market is quota free, but it is not likely to grow in near future due to economic downturn.

4 Quota hopping refers to the fact that buyers shift suppliers to countries that enjoy the best quota allocations, as long as the combination of cost and quality in these countries are satisfactory.

5 These are rough estimates. GSO figures are based on FOB prices and WTO figures are based on CIF prices.

**Table 1.** Vietnam’s exports of textiles and garments. US\$ million

	1985	1990	1995	2000	2001
Textiles	6.5	27.8	190	417	443
Garments	21.1	90.7	660	1475	1519
Total	27.6	118.5	850	1892	1962

Source: Hill (1998) for 1985 and 1990, VITAS (2002) for the remainder.

**Table 2.** Output and exports of the textile and garment industry in Sri Lanka 1980–2002<sup>1</sup>

	Output			Exports	
	Current prices (Rs. million)	1996 prices (Rs. million)	Avr. annual growth (%)	Current prices (US\$ million)	Avr. annual growth (%)
1980	1,879	9,937		110	
1985	9,505	28,021		290	
1990	27,930	49,600		628	
1980–1990			8.0		8.2
1995	104,602	117,267		1853	
2000	215,686	170,800		2982	
1990–2000			7.0		7.9
2001	224,898	154,942		2543	
2002				2424	

Note: <sup>1</sup>The nomenclature in statistics on output is ‘textiles, wearing apparel and leather products’. Production of the latter in Sri Lanka is negligible.  
Source: Central Bank, 1987a,b, 2003a,b, 2004; Karunatilake, 1987; Central Bank reference in International Centre for Ethnic Studies, 2002.

In fixed prices, Sri Lanka experienced a fivefold increase in the value of production in the textile and garment industry from 1980 to 1990. From 1990 to 2000 the increase was more than threefold. Likewise, the value of exports of textiles and garments more than quadrupled from 1990 to 2000 from US\$628 million to US\$2,982 million. Garments accounted for about 90% of it (Central Bank of Sri Lanka, 1999). In 2001 exports of textiles and garments started to decline (Table 2). The growth in the 1980s and 1990s is impressive. The civil war from 1983 did not prevent the industry to flourish in the first place, but it may have deterred some foreign involvement and imposed extra controls on imports, which in turn increased lead-times. Although the industry is not located in the war zone, there are occasional insurgencies in the Colombo area. Having said all this, representatives of the buying offices did not mention the civil war as a major impediment to business.

The decline in 2001 is attributed to declining prices of garments in the international market. Due to a global slow-down, consumer-spending forecasts were revized downward in the USA and in the EU there was a demand for large discounts on high value-added garments. Meanwhile labour productivity in the Sri Lankan garment industry was lagging behind the most competitive countries. The situation in 2001 was worsened by a number of local power-cuts and an attack on the Katunayake International Airport (Central Bank

of Sri Lanka, 2001; Bharattextile.com, 2002, 2003). Exports of textile and garments continue to decline, although only slightly in 2002. Both in the USA and the EU Sri Lanka experiences the effects of increasing market penetration by China. In addition, there is severe competition from some Caribbean countries and India in the US market and from some Pan-Euromed countries and India in the EU (Central Bank of Sri Lanka, 2004; WTO, 2003).

The largest export market of garments from Sri Lanka is the USA, which accounts for about 60% of it in value. This market is almost exclusively a quota market. Another 34% are exported to the European Union (EU). With effect from 1<sup>st</sup> March 2001, quota restrictions on exports of garments from Sri Lanka to the EU were fully abolished (Kelegama and Foley, 1999; International Textile Briefs, 2000, 2001; Monjack, 2000; European Commission, 2001). Exports to the EU declined from 874 million ecu to 802 million ecu from 2000 to 2001. In contrast, Vietnam's exports to the EU have been increasing. With exports worth 797 million ecu in 2001, it reached almost the same level as Sri Lanka (statistics obtained from EU Directorate General Trade, Dec. 2002). This illustrates the intensification of price-competition in the garment industry following the phase-out of the quota system.

The textile and garment industry is important to the economy of both countries, although Sri Lanka accounts for only 1% of world exports of garments and Vietnam even less (WTO, 2000b). In 1999 the textile and garment industry in Vietnam accounted for 8% of the gross output value of the industrial sector and in 2001 the textile and garment industry accounted for 13% of Vietnam's total exports (GSO, 2001; CIEM, 2002). With 80 million inhabitants Vietnam has a larger home market for industrial products than Sri Lanka with 19 million inhabitants. Sri Lanka's economy is less diversified and the country is thus more dependent on the textile and garment industry than Vietnam. In Sri Lanka the industry accounts for 45% of the gross output value of the industrial sector and 53% of total exports in 2001 (Central Bank of Sri Lanka, 2003a).

It is food for thought that net export earnings of the garment industry is low in both countries. In Vietnam the value of imports of yarn, fibre and accessories 1999–2001 are higher than the total value of the exports of the textile and garment industry (VITAS, 2002). One of the buyers holds that only 25–30% of the free on board (FOB) prices of garments remain in Vietnam, and according to MPDF (2000), value-added in cut, make and trim (CMT) production is about 20%.<sup>6</sup> In Sri Lanka net export earnings of the garment industry are 30–40% less the value of gross exports. Value-added in the textile *and* garment industry is about 40% (Central Bank of Sri Lanka, 1999). In garments it is held to be 30–35% (Saheed, 2000).

## 6. Direct buyers and middlemen

Middlemen act in different ways. In Vietnam they are either brokers and do the business negotiations on behalf of the lead firms or they buy themselves and re-export to the lead firms. They come from Taiwan, South Korea, and Hong Kong. Manufacturers prefer big middlemen because they can ensure a stable market. Moreover, if the customers reject the

6 Trim refers to the process of finishing and decoration. The figures are consistent with the industrial survey of Vietnam (GSO, 2000). Value-added constituted 29% of gross output in the garment industry. Imports of raw materials are higher in production of garments for exports than for the domestic market.

products after the middlemen have approved them, it is the middlemen who have to bear the costs. The strong reliance on middlemen should be understood in light of the transition-economy context. Over a long time it has been politically difficult to establish contacts abroad. However, industry representatives report that increasingly more lead firms prefer to deal directly with the manufacturers and set up their own offices in Vietnam. Accordingly, middlemen demand a mark-up of 10–15%, and with lower prices in the final market, there are lead firms who think that they cannot afford them. The manufacturers claim that price negotiations are so hard that they do not earn more when middlemen are omitted.

Manufacturers in Sri Lanka are less dependent on middlemen than manufacturers in Vietnam. In Sri Lanka buyers from the USA or Europe usually set up a local buying office, i.e., representative office that it finances. The buying office selects the local suppliers, coordinates the orders, provides the suppliers with product designs developed in the USA or Europe and checks the quality of production. They often have a regional co-ordinating office in Hong Kong, which among other things takes care of purchasing of raw materials and accessories.

## **7. Industrial upgrading: demanding buyers, but limited assistance**

The bulk of the garment industry in both countries is of the cut-make (CM) type, i.e., either cut-make-trim or cut-make-trim-pack. Some free on board (FOB) production has developed in both countries, but mainly during the last two-three years (since 1999/2000) in Vietnam (interview with buyer). Fourteen of the nineteen garment manufacturers in Vietnam do some FOB production and it is found in all four categories of enterprises, i.e., foreign, private Vietnamese, SOEs, and SOEs in joint ventures (Table 3). As opposed to CMT, FOB production is ‘full-package’ work. The manufacturers source their own inputs and are capable of opening a letter of credit and of taking charge of procurement. It is a sign of technology upgrading quality wise and upgrading at the management level regarding the organization of production and sales. One of the FOB buyers holds that they work in partnership with their suppliers in order to make plans for the season and ensure that they have the necessary production capacity and export quotas. The manufacturers did not report such organizational assistance, but it is not uncommon that the buyers tell them where to purchase fabrics. Undoubtedly exposure to the demands of the buyers has contributed to the upgrading.

FOB production can be a mixed blessing to the manufacturers. As one buyer explained: ‘we prefer FOB because then the manufacturers take all the risks’ (interview). In practice, it is not easy for the manufacturers to attain higher profits by procurement of raw materials, and manufacturers in Vietnam argue that CM production is advantageous to them. Their buyers have long experience, good connections, and know better than them where to get raw materials at the best price. This situation is also indicative of the problem Vietnamese manufacturers face regarding access to information about international markets and the fact that domestic backward linkages in the industry are scarce (below). There are signs that demand for ‘full-package’ work increases among buyers in the USA. It is especially suppliers in China who have developed competence in this field, but Mexican suppliers are also gaining such experience (Scott, 2002). This represents a challenge to the garment industry in Vietnam.

Table 3. Buyer-assisted upgrading of garment manufacturers in Vietnam

Enterprise	FOB ability	Buyers	Buyer-assisted upgrading			New lines	Assisted by	Profits
			Product	Process	Machines			
Priv. 1	x	Di.						Decline
Priv. 2		Mi.		x			Mi.	No answer
Priv. 3	x	Di.&Mi.						Decline
Priv. 4		Di.&Mi.						Decline
Priv. 5	x	Di.&Mi.	x	x	x		Di.&Mi.	Improve
Priv. 6		Mi.			x		Mi.	Decline
Foreign 1	x	Di.						Decline
Foreign 2	x	Di.						No answer
Foreign 3	x	Di.						Are low
SOE j.v. 1	x	Di.&Mi.						Decline
SOE j.v.2		Di.						No answer
SOE 1	x	Di.&Mi.						Decline
SOE 2	x	Di.&Mi.			x		Di.	Are low
SOE 3	x	Di.&Mi.		x	x		Mi.	Decline
SOE 4	x	Mi.				x	Mi.	Decline
SOE 5		Mi.						Decline
SOE 6	x	Mi.						Decline
SOE 7	x	Mi.						Decline
SOE 8	x	Di.&Mi.						Decline

Notes: Priv. refers to private Vietnamese enterprise, j.v. refers to joint venture, di. refers to direct buyers and mi. refers to middlemen. FOB refers to the fact that the enterprises have the ability to and do some FOB production, which is a sign of technology upgrading quality wise and upgrading at the management level regarding the organization of production and sales. Buyers refer to the types of buyers to which the enterprises cater. Product refers to assistance to develop a specific product into a more advanced product, i.e., assistance over and above access to prototypes and regular quality checks. Process refers to assistance to undertake changes in the organization of the production line in order to reduce mistakes and time of production. Machinery refers to credit or practical assistance or both in order to purchase machinery. New lines refer to practical assistance and credit to set up production lines from scratch in order to expand production.

Source: Interviews in Vietnam, fieldwork 2002.

On questions regarding technological changes, industry representatives in Sri Lanka emphasize that the garment industry does not manufacture the most basic items anymore. During the last 10–15 years there has been a gradual upgrading of the garment industry from export-oriented production of simple budget clothes to exports of branded garments for the middle market and even for the more fashion-oriented high-end market. According to Ministry of Industrial Development, 40% of the production is directed at the budget market, 50% at the middle market, and 10% at the upper market (reference in Kelegama and Foley, 1999). Vietnam caters to a lesser extent than Sri Lanka to the fashion high-end market with short lead-times. However, with respect to skills, a buyer who has operated in both countries holds that manufacturers in Vietnam make as complicated products as manufacturers in Sri Lanka.

There is an element of technology transfer in access to new designs for more advanced products in the form of product specifications and patterns. In addition, some learning results from regular quality control. All of the manufacturers in the two case studies get access to product specifications and design and are subject to quality controls. However,

the learning process is so incremental that they do not usually think of it in terms of technology transfer. In Sri Lanka a buyer complained that controllers are better at pinpointing mistakes, than in teaching the workers how to correct them. It is also a big challenge to move from more systematic and regular quality control to quality assurance by spot checks.

Only six of the 19 manufacturers in Vietnam reported that they receive technological assistance from their buyers beyond access to proto-types and quality checks that everybody is subject to (Table 3). The manufacturers are either private Vietnamese enterprises or SOEs and both direct buyers and middlemen provide technological assistance. Upgrading of the production process includes organizational changes to avoid bottlenecks in the production.

The three wholly owned foreign enterprises did not report any technological assistance from their buyers. Two of them bring in their own technology in terms of design and brand-names. The third manufactures brand-name products for buyers who cater to high quality market niches in Europe. Only two of the state-owned enterprises in the sample have formed joint ventures with foreign enterprises. In both cases the Vietnamese party reports that the foreign partner provides access to markets, but that they do not contribute any technology upgrading. It is the foreign partner who takes care of marketing. In one of the joint ventures it was specifically mentioned that if the foreign partner should quit, the enterprise would have to find new customers or shift to other activities than textiles and garments.

In Sri Lanka there has not been any significant technological upgrading in terms of machinery excepting the introduction of some speciality machines recommended by direct buyers. Manufacturers attribute this to high costs of automation, and that those who have the necessary resources would rather invest in a business with higher returns. In Vietnam direct buyers and a former middleman report that they select manufacturers who have the required machinery in place at the outset and do not interfere with the production line.

In sum, the general view of the manufacturers in both countries is that their buyers are demanding, but to a limited degree actively intervening in industrial upgrading. In the interviews the buyers confirm this. Hence, the findings do not support the theoretical argument that buyers are likely to assist in industrial upgrading in order to secure their relational rents. This applies both to direct buyers and middlemen. Neither are there any signs in the material from Vietnam that foreign counterparts in joint ventures are more inclined than buyers to contribute industrial upgrading of the local partner. Likewise, case studies of the garment industry in Indonesia and Slovakia conclude that transfer of design and marketing skills in networks are very or severely limited. Control of such skills enables the buyers to capture value (Dicken and Hassler, 2000; Smith et al., 2002).

## **8. Local linkages are difficult to attain**

Local linkages between the garment industry and manufacturing suppliers of inputs and machinery are few in Vietnam and Sri Lanka. In both countries products are made according to the specifications of the buyers who also usually provide imported fabrics, or instruct the manufacturers from where to import. The point is to ensure the right quality and uniform products when garments are sourced from different manufacturers.

Vietnam cultivates cotton, but is not internationally competitive in quality and price. Neither is the textile industry in Vietnam capable of competing with imports at the low price and high quality that the buyers require. In Sri Lanka lead-times must come down from 90–100 days to 45 days (interviews). This is a big challenge when only 10% of the fabrics required for exports of garments are manufactured in the country (Saheed, 2000). Unlike Vietnam, Sri Lanka does not cultivate cotton. Moreover, textile mills are costly to set up and it is difficult to mobilize capital for this purpose. However, some facilities for manufacture of trims and accessories exist (Kelegama and Foley, 1999; Weerasinghe 2000).

The above offers some points of resemblance with findings from Indonesia (Dicken and Hassler, 2000). Despite the existence of a large local textile industry in Indonesia and the fact that some foreign buyers prefer their suppliers to source locally in order to reduce lead-times, most of the fabrics used in export-oriented manufacture of garments are imported. Machinery in Indonesia is new, but productivity remains low due to high costs of investments. This means that the price of locally manufactured fabrics is relatively high compared to imports.

Trade policy of importing countries is also a factor that impedes creation of backward linkages. The EU recommends that Vietnam in addition to creation of local linkages, imports more fabrics for assembling into 'high quality top-end products' for re-exports to the EU. The latter can be done in accordance with the system of 'outward processing traffic' which grants additional quotas for exports to the EU (EU Economic Counsellors in Hanoi, 2001). In the agreement between the EU and Vietnam of 15 February 2003, the EU increases the textile and garment quotas to Vietnam worth 200 million euro a year till 2005. In return Vietnam has to reduce duties on imports of textiles and garments to less than 50% of the present level and also liberalize trade in other sectors (EU, 2003). Likewise, in return for quota-free access to the EU market in 2001, Sri Lanka has to open for textiles and garments exported from the EU.

Vietnam imports 20 000 tonnes of cotton from the USA (Vietnam Investment Review, 27 May–2 June 2002), which equals about 25% of the country's imports of cotton in 2000 (GSO, 2001). US cotton is dependent on government protection for survival in the market (Townsend, 2002). The practice of the USA and the EU in this respect is indicative of displacement competition and is not exceptional to relations with Vietnam and Sri Lanka. Trade agreements in the Pan-Euromed zone as well as the Caribbean Basin Trade Partnership Act and the African Growth and Opportunity Act contain provisions that link market access to imports of textiles manufactured in the EU and the USA as a means to protect industry and employment in these countries. Those who lobby for such trade policies are manufacturers and trade unions in the EU and the USA that want to increase exports. Buyers take advantage of the opportunities that this gives.

In the case of Vietnam, East-Asian companies that act as middlemen source fabrics from their home-country textile industries (Tran, 1997). In South-Korea and Taiwan, production of fibres and textiles has increased over time. This has been stimulated by exports of textiles to manufacturers of garments in networks co-ordinated by companies from the two countries (Gereffi, 1996). The point is underscored by Dicken and Hassler (2000) who write that a large share of higher value fabrics for export manufacturing is imported to Indonesia from first generation NIEs.

The above implies that there are potential conflicts of interest over location of backward linkages in buyer-driven networks and that the dynamics of the networks can impede local linkages.

## 9. Profit margins dip

Only one of the 19 garment manufacturers in Vietnam mentions that profit margins improve. Three manufacturers did not answer the question. Otherwise, the manufacturers experience that profit margins are low or diminish, but production volumes and turnover increase (Table 3). Buyers are also of the impression that profit margins of the manufacturers decline (interviews). An independent industry representative with long experience from the state and private sectors holds that profit margins generally range between 5–10% in garments, but they may be as high as 20%. This is consistent with the answers of the manufacturers. Manufacturers report that there is a distinct pressure to reduce prices, especially by Japanese customers ‘who always refer to Chinese cost levels and prices’. This is a general sentiment in the industry and also occurs in Sri Lanka. Competition from China is serious to the Vietnamese textile and garment industry. However, it also appears to be an argument used for what it is worth in price negotiations. One of the buyers held that among the countries in Asia, they enjoy the best prices in Vietnam. Likewise, a former buyer who is still in the industry argues that prices are not much lower in China than in Vietnam.

Taking into consideration the competition for manufacturing capacity among the buyers with the opening of the US market, it is surprising that the manufacturers in Vietnam do not attain increasing profit margins. There are more reasons for this. First, there is a need for access to the US market because of stagnation in the Japanese market and quota limitations in the EU market. Despite increasing exports to the EU, the manufacturers claim that they experience limitations. Second, there was a race among the manufacturers to get a good footing in the US market before the USA imposed quota restrictions. Third, with China as the main competitor, it is difficult to press prices upwards. China’s competitive advantage is low prices in combination with competence in ‘full-package’ work. Moreover, as a member of WTO, China benefits from the phase-out of the quota system. This is an advantage vis-à-vis Vietnam in the European and US market.

In the case of Sri Lanka, a key industry representative argues that garment manufacturers earn more profits in 2000 than before due to increasingly larger quantities of exports. However, profit margins per unit ‘dip lightly’. This is a case in point as some upgrading of product quality has taken place. Sri Lanka is ahead of Vietnam when it comes to exports of fashion products with short lead times and also deal more directly with the buyers through their local buying offices. The same person holds that prices have come down 20% the last two-three years (1997–2000), investments to meet quality requirements have become more costly and gross profit margins are 10–15%. In comparison, the gross profit margin of six randomly chosen garment manufacturers in the Katunayake EPZ was 26% in 1989–1994 (Edwards, 1996).<sup>7</sup> International prices for garments have continued to fall and so has the value of exports from Sri Lanka since 2001. From October 2001 to June 2002, world apparel prices are claimed to have declined by 30% (Bharattextile.com, 2002). According to

7 In national statistics for Sri Lanka profit margins for the category of wearing apparel varied from 30% in 1991 to 40% in 1992, 50% in 1993, and minus 20% in 1994 (Slater et al., 1997). The latter was a year with labour unrest. In 1996 the profit margin was 30% (Department of Census and Statistics, 1999). Profit margins are measured in terms of price-cost margins, and capital expenditure are not included in the figures.



Euratex (2002) the unit value of exports of textile and garments from Asia to the EU declined by 6.3% from 2000 to 2001.

## 10. Concluding discussion

The dependence on middlemen in Vietnam corroborates the expectation that the transition economy context weakens the leverage of the manufacturers in negotiations for gains in buyer-driven networks. However, leverage in buyer-driven networks to retain more of the value is not strong in the case of Sri Lanka either, judging from the fact that profit margins decline. Both countries have experienced growth in the garment industry, although Sri Lanka has experienced decline since 2001. This is a case in point, as the industry in Sri Lanka by that time had graduated to more demanding market segments; thus it should be able to attain higher technology rents and brand-name rents and thereby be able to grow and further improve its competitiveness. The fact that this is not the case, underscores the importance of a flat market and strong price-competition in explaining impediments to industrial development.

Technological changes in the industry are small and incremental in both countries. Among the few manufacturers in Vietnam who answer that they have received technological assistance from their buyers, only one reports increasing profit margins (Table 3). Not only is the contribution of buyers and lead firms to technological change limited in Vietnam and Sri Lanka. Technology rents, organizational rents, and brand-name rents, whether created with assistance from buyers or not, accrue to foreign buyers and lead firms as relational rents. A part of the surplus is used to reduce the price in the retail market in order to stimulate demand. However, figures from the EU imply that manufacturers are harder hit by price competition than lead firms. From 2000 to 2001 the import price of garments to the EU declined by 4.8% whereas the consumer price declined by 1.1% (Euratex, 2002). Internationally the competitive environment is so keen and the power of the buyers so strong that it is difficult for the manufacturers in the two countries to make demands on the buyers.

Both countries experience few local linkages between the garment industry and its supplier industries. More linkages between the local textile industry and the export-oriented garment industry would increase value-added and improve net export earnings, which are low in both countries. It would also reduce lead-times that are important to enhance the flexibility of the industry, a necessary factor to ensure competitiveness in the longer run. Trade policies of countries that already have well-established textile and fibre industries contribute to inhibit this. This illustrates power relations in favour of the first-comers in the global textile and garment industry, which is the point of Senghaas (1985). According to the findings of Dicken and Hassler (2000) in Indonesia, the previous involvement of NIEs in the garment industry helps them sustain their present place in the network as buyers of garments and suppliers of fabrics. In sum this means that there are strong external impediments to attain the effective local supply base that Gereffi (1996) argues is a condition to attain industrial development. This and the fact that the buyers capture the bulk of technology rents imply that impediments to industrial development in the two cases cannot fully be explained by contingencies at the country-specific scale. An explanation in the intersection of time-specific international conditions and network dynamics is more valid.

Regarding time-specific international conditions, the slowing of the world economy makes the retail market more price-sensitive and consumption is weak in all major

industrial markets (Euratex, 2002). Hence, to be able to protect their own profits, buyers pass the costs of price-cutting in the retail market down to the manufacturers. The argument fits Semlinger's (1991) point that adjustment costs are passed down the network during economic downturn. The buyers capture rents that the manufacturers attain when they upgrade, but invest as little as possible in the process of upgrading. This can be done because competition for market access among the manufacturers is rife. Competition has increased over time with more and more entrants on the export market. Does this mean that the impediments observed are just a matter of time-specific international conditions and short-term economic recessions?

No, there are factors inherent to buyer-driven networks that suggest that they are more likely to impede than promote industrial development. Buyer-driven networks started to form in technologically mature and labour intensive industries with low entry barriers as a response to the long-term crisis in the international economy starting in the late 1960s/early 1970s. The textile and garment industry has also suffered from a general condition of market saturation since then. Buyer-driven networks represent a strategy for firms in high-cost countries to retain and increase their profits based on capture of value. Price-competition which is characteristic to the industries they develop in, delimits how much can be captured from the final market. In contrast, hard competition among suppliers for market outlets makes it relatively easier to capture value at the manufacturing end. Lead firms succeed in this because they are big and powerful. Although manufacturers may be stimulated to upgrade due to keen competition within the system of buyer-driven networks, this cannot be sustained as long as the lead firms acquire the bulk of the value. This suggests that there are severe problems of impediments to industrial development that are inherent to buyer-driven networks, or more precisely, that the impediments can be explained by characteristics of the industries that the networks tend to develop in.

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